

GOLDMAN SACHS GROUP INC/

Form 10-Q

July 03, 2006

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-Q

- x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934.**

For the quarterly period ended May 26, 2006

or

- o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934.**

For the transition period to

Commission File Number: 001-14965

**The Goldman Sachs Group, Inc.
(Exact name of registrant as specified in its charter)**

**Delaware
(State or other jurisdiction
of incorporation or organization)**

**13-4019460
(I.R.S. Employer
Identification No.)**

**85 Broad Street, New York, NY
(Address of principal executive offices)**

**10004
(Zip Code)**

**(212) 902-1000
(Registrant's telephone number, including area code)**

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. **x**

Yes ☐ No ☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

☐ Yes ☒ No

APPLICABLE ONLY TO CORPORATE ISSUERS

As of June 23, 2006 there were 431,695,902 shares of the registrant's common stock outstanding.

THE GOLDMAN SACHS GROUP, INC.
QUARTERLY REPORT ON FORM 10-Q FOR THE FISCAL QUARTER ENDED MAY 26, 2006
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THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
(UNAUDITED)

	Three Months		Six Months	
	Ended May		Ended May	
	2006	2005	2006	2005
	(in millions, except per share amounts)			
Revenues				
Investment banking	\$ 1,521	\$ 796	\$ 2,991	\$ 1,669
Trading and principal investments	6,921	2,562	13,608	6,703
Asset management and securities services	1,016	724	2,570	1,498
Interest income	8,544	4,867	16,079	9,043
 Total revenues	 18,002	 8,949	 35,248	 18,913
Interest expense	7,761	4,022	14,574	7,471
Cost of power generation	144	121	242	231
 Revenues, net of interest expense and cost of power generation	 10,097	 4,806	 20,432	 11,211
Operating expenses				
Compensation and benefits	5,086	2,403	10,387	5,606
 Brokerage, clearing and exchange fees	 403	 274	 754	 526
Market development	121	94	221	176
Communications and technology	131	123	255	241
Depreciation and amortization	127	128	252	246
Amortization of identifiable intangible assets	44	31	78	62
Occupancy	199	186	392	334
Professional fees	123	109	232	205
Other expenses	339	214	648	426
 Total non-compensation expenses	 1,487	 1,159	 2,832	 2,216
 Total operating expenses	 6,573	 3,562	 13,219	 7,822
 Pre-tax earnings	 3,524	 1,244	 7,213	 3,389
Provision for taxes	1,212	379	2,422	1,012
 Net earnings	 2,312	 865	 4,791	 2,377
Preferred stock dividends	26		52	

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Net earnings applicable to common shareholders	\$ 2,286	\$ 865	\$ 4,739	\$ 2,377
Earnings per common share				
Basic	\$ 5.08	\$ 1.78	\$ 10.45	\$ 4.85
Diluted	4.78	1.71	9.86	4.65
Dividends declared per common share	\$ 0.35	\$ 0.25	\$ 0.70	\$ 0.50
Average common shares outstanding				
Basic	449.7	485.4	453.5	489.8
Diluted	478.3	506.2	480.8	510.7

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents**THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(UNAUDITED)**

	As of	
	May 2006	November 2005
	(in millions, except share and per share amounts)	
Assets		
Cash and cash equivalents	\$ 7,722	\$ 10,261
Cash and securities segregated for regulatory and other purposes	70,740	51,405
Receivables from brokers, dealers and clearing organizations	24,848	15,150
Receivables from customers and counterparties	68,769	60,231
Securities borrowed	210,287	191,800
Securities purchased under agreements to resell	86,944	83,619
Financial instruments owned, at fair value	268,169	238,043
Financial instruments owned and pledged as collateral, at fair value	41,986	38,983
Total financial instruments owned, at fair value	310,155	277,026
Other assets	19,419	17,312
Total assets	\$ 798,884	\$ 706,804
Liabilities and shareholders' equity		
Secured short-term borrowings	\$ 9,984	\$ 7,972
Unsecured short-term borrowings	52,337	47,247
Total short-term borrowings, including the current portion of long-term borrowings	62,321	55,219
Payables to brokers, dealers and clearing organizations	12,078	10,014
Payables to customers and counterparties	192,815	178,304
Securities loaned	38,838	23,331
Securities sold under agreements to repurchase	146,909	149,026
Financial instruments sold, but not yet purchased, at fair value	159,801	149,071
Other liabilities and accrued expenses	28,732	13,830
Secured long-term borrowings	17,844	15,669
Unsecured long-term borrowings	107,746	84,338
Total long-term borrowings	125,590	100,007
Total liabilities	767,084	678,802
Commitments, contingencies and guarantees		

Shareholders' equity

Preferred stock, par value \$0.01 per share; 150,000,000 shares authorized, 104,000 and 70,000 shares issued and outstanding as of May 2006 and November 2005, respectively, with liquidation preference of \$25,000 per share	2,600	1,750
Common stock, par value \$0.01 per share; 4,000,000,000 shares authorized, 593,527,373 and 573,970,935 shares issued as of May 2006 and November 2005, respectively, and 431,115,828 and 437,170,695 shares outstanding as of May 2006 and November 2005, respectively	6	6
Restricted stock units and employee stock options	3,576	3,415
Nonvoting common stock, par value \$0.01 per share; 200,000,000 shares authorized, no shares issued and outstanding		
Additional paid-in capital	19,076	17,159
Retained earnings	23,536	19,085
Accumulated other comprehensive income	11	
Common stock held in treasury, at cost, par value \$0.01 per share; 162,411,545 and 136,800,240 shares as of May 2006 and November 2005, respectively	(17,005)	(13,413)
Total shareholders' equity	31,800	28,002
Total liabilities and shareholders' equity	\$ 798,884	\$ 706,804

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents**THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(UNAUDITED)**

	Period Ended	
	May 2006	November 2005
	(in millions, except per share amounts)	
Preferred stock		
Balance, beginning of year	\$ 1,750	\$
Issued	850	1,750
Balance, end of period	2,600	1,750
Common stock, par value \$0.01 per share		
Balance, beginning of year	6	6
Issued		
Balance, end of period	6	6
Restricted stock units and employee stock options		
Balance, beginning of year	3,415	2,013
Issued	970	1,871
Delivered	(701)	(423)
Forfeited	(107)	(37)
Options exercised	(1)	(9)
Balance, end of period	3,576	3,415
Additional paid-in capital		
Balance, beginning of year	17,159	15,501
Issuance of common stock	1,483	1,417
Preferred stock issuance costs	(1)	(31)
Excess tax benefit related to share-based compensation	435	272
Balance, end of period	19,076	17,159
Retained earnings		
Balance, beginning of year	19,085	13,970
Net earnings	4,791	5,626
Dividends declared on common stock	(288)	(494)
Dividends declared on preferred stock	(52)	(17)
Balance, end of period	23,536	19,085
Unearned compensation		

Balance, beginning of year		(117)
Amortization of restricted stock units		117
Balance, end of period		
Accumulated other comprehensive income		
Balance, beginning of year		11
Currency translation adjustment, net of tax	27	(27)
Minimum pension liability adjustment, net of tax		(11)
Net (losses)/gains on cash flow hedges, net of tax	(2)	9
Net unrealized (losses)/gains on available-for-sale securities, net of tax	(14)	18
Balance, end of period	11	
Common stock held in treasury, at cost		
Balance, beginning of year	(13,413)	(6,305)
Repurchased	(3,592)	(7,108)
Balance, end of period	(17,005)	(13,413)
Total shareholders' equity	\$ 31,800	\$ 28,002

The accompanying notes are an integral part of these condensed consolidated financial statements.

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THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Six Months Ended May	
	2006	2005
	(in millions)	
Cash flows from operating activities		
Net earnings	\$ 4,791	\$ 2,377
Non-cash items included in net earnings		
Depreciation and amortization	365	335
Amortization of identifiable intangible assets	113	93
Share-based compensation	611	420
Changes in operating assets and liabilities		
Cash and securities segregated for regulatory and other purposes	(10,786)	982
Net receivables from brokers, dealers and clearing organizations	(7,634)	(1,971)
Net payables to customers and counterparties	6,768	15,847
Securities borrowed, net of securities loaned	(2,980)	(20,914)
Securities sold under agreements to repurchase, net of securities purchased under agreements to resell	(5,442)	15,535
Financial instruments owned, at fair value	(36,270)	(28,759)
Financial instruments sold, but not yet purchased, at fair value	10,380	10,289
Other, net	5,792	(1,697)
Net cash used for operating activities	(34,292)	(7,463)
Cash flows from investing activities		
Purchase of property, leasehold improvements and equipment	(1,183)	(639)
Proceeds from sales of property, leasehold improvements and equipment	149	28
Business acquisitions, net of cash acquired	(563)	(438)
Proceeds from sales of investments	1,191	
Net cash used for investing activities	(406)	(1,049)
Cash flows from financing activities		
Short-term borrowings, net	6,055	(1,168)
Issuance of long-term borrowings	36,438	25,603
Repayment of long-term borrowings, including the current portion of long-term borrowings	(10,949)	(11,194)
Derivative contracts with a financing element, net	2,267	695
Common stock repurchased	(3,592)	(2,906)
Dividends paid on common and preferred stock	(340)	(254)
Proceeds from issuance of common stock	1,125	675
Proceeds from issuance of preferred stock, net of issuance costs	849	738
Excess tax benefit related to share-based compensation	306	
Net cash provided by financing activities	32,159	12,189

Net (decrease)/increase in cash and cash equivalents	(2,539)	3,677
Cash and cash equivalents, beginning of year	10,261	4,365
Cash and cash equivalents, end of period	\$ 7,722	\$ 8,042

SUPPLEMENTAL DISCLOSURES:

Cash payments for interest, net of capitalized interest, were \$14.03 billion and \$7.31 billion during the six months ended May 2006 and May 2005, respectively.

Cash payments for income taxes, net of refunds, were \$1.63 billion and \$1.36 billion during the six months ended May 2006 and May 2005, respectively.

Non-cash activities:

The firm assumed \$190 million and \$758 million of debt in connection with business acquisitions during the six months ended May 2006 and May 2005, respectively.

The accompanying notes are an integral part of these condensed consolidated financial statements.

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THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

	Three Months Ended May		Six Months Ended May	
	2006	2005	2006	2005
	(in millions)			
Net earnings	\$ 2,312	\$ 865	\$ 4,791	\$ 2,377
Currency translation adjustment, net of tax	10	(17)	27	(17)
Net (losses)/gains on cash flow hedges, net of tax	(3)	4	(2)	4
Net unrealized losses on available-for-sale securities, net of tax	(11)		(14)	
Comprehensive income	\$ 2,308	\$ 852	\$ 4,802	\$ 2,364

The accompanying notes are an integral part of these condensed consolidated financial statements.

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THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)**

Note 1. Description of Business

The Goldman Sachs Group, Inc. (Group Inc.), a Delaware corporation, together with its consolidated subsidiaries (collectively, the firm), is a leading global investment banking, securities and investment management firm that provides a wide range of services worldwide to a substantial and diversified client base that includes corporations, financial institutions, governments and high-net-worth individuals.

The firm's activities are divided into three segments:

Investment Banking. The firm provides a broad range of investment banking services to a diverse group of corporations, financial institutions, governments and individuals.

Trading and Principal Investments. The firm facilitates client transactions with a diverse group of corporations, financial institutions, governments and individuals and takes proprietary positions through market making in, trading of and investing in fixed income and equity products, currencies, commodities and derivatives on such products. In addition, the firm engages in specialist and market-making activities on equities and options exchanges and clears client transactions on major stock, options and futures exchanges worldwide. In connection with the firm's merchant banking and other investing activities, the firm makes principal investments directly and through funds that the firm raises and manages.

Asset Management and Securities Services. The firm provides investment advisory and financial planning services and offers investment products across all major asset classes to a diverse group of institutions and individuals worldwide, and provides prime brokerage services, financing services and securities lending services to mutual funds, pension funds, hedge funds, foundations and high-net-worth individuals worldwide.

Note 2. Significant Accounting Policies

Basis of Presentation

These condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles that require management to make certain estimates and assumptions. The most important of these estimates and assumptions relate to fair value measurements, the accounting for goodwill and identifiable intangible assets, the determination of compensation and benefits expenses for interim periods, and the provision for potential losses that may arise from litigation and regulatory proceedings and tax audits. Although these and other estimates and assumptions are based on the best available information, actual results could be materially different from these estimates.

These condensed consolidated financial statements include the accounts of Group Inc. and all other entities in which the firm has a controlling financial interest. All material intercompany transactions and balances have been eliminated.

The firm determines whether it has a controlling financial interest in an entity by first evaluating whether the entity is a voting interest entity, a variable interest entity (VIE) or a qualifying special-purpose entity (QSPE) under generally accepted accounting principles.

Voting Interest Entities. Voting interest entities are entities in which (i) the total equity investment at risk is sufficient to enable the entity to finance its activities independently and (ii) the equity ho